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To: The Governor's Advisory Council on School Funding

From: Amy Carlson
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RE: Declining enrollment, budget caps, and options for Averaging ANB to mitigate the effects

This report contains two sections. The first addresses declining enrollments effects on school district general fund budgets. Declining enrollment has been seen as a significant problem facing school budgets in recent years. This section gives an overview of the problem, then using example districts shows how declining or increasing enrollment affects their general fund budget and summarizes the effects at the state level.

The second section provides analysis the Council requested on averaging ANB to soften the reductions to budgets currently required as a result of declining enrollment. This analysis uses the same six example districts for demonstration then gives an overall state perspective.

Section 1: Declining Enrollment and General Fund Budget Caps

Table 1 on the following page demonstrates the distribution of districts within the general fund "equalization window" from FY 1995 to 2001. The equalization window is defined as 80% to 100% of the entitlements. When enacted, the school funding statute required all districts to be at or above 80% by FY 1998 and froze budgets of districts over 100%. The intent was to over time, bring all districts into the "equalization window".

In FY 1995, 106 districts had not yet budgeted up to the BASE funding level and 106 (22.5%) districts were budgeted at 97% or greater of the maximum budgets. By FY

2001, 185 (41.3%) districts budgeted at or above 97% of maximum budgets and no districts are below BASE budgets (as required by law).

The number of districts above the general fund maximum decreased from FY 1994 to FY2000. HB 667 in the 1993 session froze budgets of districts spending over-maximum and required annual voter approval of budgeted amounts over maximum. The trend of decreasing the number of districts over the maximum ended when the law changed in the 1999 session and allowed districts with declining enrollments to remain above maximum for up to 5 years.

Districts General Fund Budgets Relative to Maximum

Table 1

Count of districts	Year						
percent group	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
below Base	106	69	41				
Base	70	69	84	130	112	104	95
<90%	129	131	123	103	98	102	96
<97%	60	69	82	71	79	64	72
97% to Max	48	86	96	123	138	156	147
Over max	58	42	37	30	29	26	38
Grand Total	**471**	**466**	**463**	**457**	**456**	**452**	**448**

Districts that have declining enrollment tend to rise toward the top of the equalization window. Of the districts whose ANB declined between 1995 and 2001, only 20% budgeted at 97% or greater in 1995, but by 2001, 55% budgeted in that range. In contrast, of the districts whose ANB increased between 1995 and 2001, 25% budgeted at or above 97% in FY 1995 and by FY 2001, this had declined to 23%. It appears that as ANB declines, budgets get pushed closer to the maximum as districts are unable or unwilling to make budgetary reductions as enrollments decline. For examples of these effects see Table 3. Decreasing budgets can cause difficult budget decisions such as closing facilities, reducing staff, or redrawing attendance areas and concerns among stakeholders.

Not all districts have declining enrollments
Between FY 2001 and FY 2002, 31% of all districts increased in the number of ANB, while 63% had declining ANB. Table 2 summarizes three years of data on the percentage of districts with increasing, decreasing or the same ANB.

Percentage of Districts: Increasing, Decreasing, or Keeping the Same ANB

Table 2

	FY 1999 to FY 2000	FY 2000 to FY 2001	FY 2001 to FY 2002
Increasing ANB	36%	37%	31%
Same ANB	8%	7%	6%
Decreasing ANB	56%	56%	63%

Although most districts anticipate declining enrollment for the next several years, over time enrollment will increase again. Any proposal to address declining enrollments must consider districts with increasing enrollments fairly.

Examples:
The examples in Table 3 on the following page illustrate six district budgets over a four-year period. The first three are districts within the equalization window and have declining enrollments. The fourth and fifth are districts with increasing enrollments, and the sixth example shows a district that is “grand fathered in” above the maximum budget.

Examples of Changes in General Fund Budgets

Table 3

		1999	2000	2001	2002	3 year change
Polaris Elementary	ANB	9	8	5	4	-55.6%
	Max budget	$50,406	$47,804	$38,343	$35,146	-30.3%
	Actual budget	$40,494	$38,398	$38,343	$36,033	-11.0%
	Percent of Max	80.3%	80.3%	100.0%	103.0%	
Troy Elementary	ANB	391	372	361	345	-11.8%
	Max budget	$1,663,853	$1,616,835	$1,658,225	$1,621,731	-2.5%
	Actual budget	$1,513,785	$1,500,224	$1,560,233	$1,575,898	4.1%
	Percent of Max	91.0%	92.8%	94.1%	97.0%	
Dawson County HS	ANB	569	532	527	490	-13.9%
	Max budget	$2,979,148	$2,857,336	$2,941,950	$2,840,375	-4.7%
	Actual budget	$2,808,000	$2,857,000	$2,924,593	$2,924,593	4.2%
	Percent of Max	94.3%	100.0%	99.4%	103.0%	
Belgrade Elementary	ANB	1,452	1,434	1,469	1,576	8.5%
	Max budget	$5,761,341	$5,839,365	$6,345,088	$6,964,180	20.9%
	Actual budget	$5,449,116	$5,596,827	$5,962,767	$6,652,970	22.1%
	Percent of Max	94.6%	95.8%	94.0%	96.0%	
Billings H S	ANB	5,418	5,532	5,625	5,630	3.9%
	Max budget	$26,057,685	$26,884,310	$28,409,415	$29,509,243	13.2%
	Actual budget	$23,204,768	$24,640,723	$25,862,295	$26,503,152	14.2%
	Percent of Max	89.1%	91.7%	91.0%	89.8%	
Outlook Schools	ANB	59	49	43	42	-28.8%
	Max budget	$538,773	$485,868	$501,878	$499,327	-7.3%
	Actual budget	$682,096	$682,096	$682,096	$679,545	-0.4%
	Percent of Max	126.6%	140.4%	135.9%	136.1%	

Explanations:

Polaris Elementary – This small district budgeted at the BASE budget in FY 1999 and FY 2000. In FY 2001 its ANB fell from 8 to 5 and Polaris chose to keep nearly the same dollar budget as it did in the prior year, which was the maximum budget it could adopt. In FY 2002, ANB at Polaris dropped one more ANB. As a result, the maximum budget fell $3,197. Polaris chose to reduce the budget $2,310 and use the "soft cap" provision passed in the 2001 legislative session and has an above maximum budget of 103% for the current year. This illustrates the extreme changes in budgets that very small schools can experience. Although the costs of very small schools may be relatively fixed, the budget authority can change dramatically.

Troy Elementary – This mid-sized elementary has been slowly losing students and slowly increasing in its percentage of the maximum budget. Troy illustrates a district that has used the flexibility of the "equalization window" to absorb some of the impacts of enrollment declines while holding down budget growth.

Dawson County High School – This mid-sized high school district has had declining enrollment in the past several years and reached the maximum budget in FY 2000. Its budget was capped by the maximum budget until FY 2002 and the new "soft cap" provisions adopted by the 2001 Legislative session. Current statute allows districts, like Dawson to stay over maximum for up to five years and must return a budget within the equalization window at the end of that five-year period.

Belgrade Elementary and Billings High School – Belgrade and Billings are examples of increasing enrollment. Although Belgrade was relatively flat for three years, it had a sudden increase in FY 2002 ANB (FY 2001 enrollment). Belgrade's budget appears to be relatively stable at about 95% of maximum budget. Likewise, Billings High School budget has remained relatively stable between 89% and 92%.

Outlook Schools –This K-12 district is an above maximum district that has been "grand fathered in" at the budget level available in FY 1993. All of the original above maximum districts were allowed to keep the above maximum level, until the maximum formula reached their budget level, at which time those districts fall under the same rules as all other districts. Declining enrollments do not directly impact above maximum district budgets.

State funding perspective:
Declining enrollment causes a reduction in the state's cost to fund schools. A 1% decline in the number of students equates to approximately $4 million less state general fund. Enrollment is anticipated to continue to decline at around 2% per year. Given current enrollment estimates and the FY 2003 entitlements, FY 2004 will have 3,075 fewer ANB and $6.3 million less cost to the state general fund than in FY 2003, likewise, FY 2005 will have 6,117 fewer ANB and $14.9 million less cost to the state general fund than in FY 2003.

This decline in enrollment and projected state savings is part of the present law budget for schools. Any change to those costs, such as increased cost for averaging is considered a new proposal in the budgeting process and will require schools to compete for general fund resources with all other general fund demands.

Section 2: Averaging ANB to Soften the Impacts to Budgets from Declining Enrollment

Delaying the impacts of enrollment changes may soften the impacts on schools that are declining in enrollment, while not negatively impacting increasing enrollment districts as it takes time for districts to increase staff and building space to the higher levels of enrollment as well as reduce staff and building space in times of declining enrollment. Three options are considered here: 5-year, 3-year, and 2-averaging of the prior years ANB. Times of dramatic change, either increases or decreases, will likely need special rules to adjust budgets outside of straight averaging. These dramatic change situations will be discussed after the three proposals.

Five-year Proposal

The five-year proposal averages the current and previous four years' ANB for each district and then uses this average as the ANB in the funding formula to determine entitlements and maximum budgets. Table 4 uses the same example districts as in Table 3 to depict the resulting effects on districts of the five-year averaging proposal.

Five-year Average Changes from Current Law

Table 4

		2001	2002
Polaris Elementary	Change in ANB	4	4
	% change in Max budget	39.2%	43.6%
	Actual budget	$38,343	$36,033
	Actual % of NEW Max	71.8%	71.4%
Troy Elementary	Change in ANB	27	32
	% change in Max budget	6.5%	8.8%
	Actual budget	$1,560,233	$1,575,898
	Actual % of NEW Max	88.4%	89.3%
Dawson County HS	Change in ANB	24	54
	% change in Max budget	3.9%	9.3%
	Actual budget	$2,924,593	$2,924,593
	Actual % of NEW Max	95.7%	94.2%
Belgrade Elementary	Change in ANB	(39)	(132)
	% change in Max budget	-2.6%	-7.5%
	Actual budget	$5,962,767	$6,652,970
	Actual % of NEW Max	96.5%	103.3%
Billings H S	Change in ANB	(160)	(119)
	% change in Max budget	-2.6%	-2.0%
	Actual budget	$25,862,295	$26,503,152
	Actual % of NEW Max	93.5%	91.7%
Outlook Schools	Change in ANB	19	11
	% change in Max budget	14.2%	9.6%
	Actual budget	$682,096	$679,545
	Actual % of NEW Max	119.0%	124.1%

Polaris Elementary – The five-year average increases the maximum budget at Polaris by 39.2% in FY 2001 and 43.6% in FY2002 over the current law level. Polaris is currently using the "soft cap" provision and has adopted an above maximum budget for FY 2002. Under the five-year average, Polaris's adopted budget for FY2002 would be 71.4% of maximum instead of 103% of maximum. 71.4% is below the BASE, which would not be permitted by statute and the district would be required to increase budget by over $4,000.

Troy Elementary – The five-year average increases the maximum budget at Troy by 6.5% in FY 2001 and 8.8% in FY2002. Under current law Troy budgets at 97.0% of

maximum budget for FY2002, while under the five-year average 89.3% of maximum. The five-year average will have no effect on the adopted budget.

Dawson County High School – The five-year average increases the maximum budget at Dawson by 3.9% in FY 2001 and 9.3% in FY2002. Under current law this district is using the "soft cap" provision and has adopted an above maximum budget for the current year. Under the five-year average, Dawson's adopted budget for FY2002 would be 94.2% of maximum instead of 103.0% of maximum. Under the five-year average Dawson could have adopted a higher budget.

Belgrade Elementary – The five-year average decreases the maximum budget for Belgrade by 2.6% in FY 2001 and 7.5% in FY2002. Under current law Belgrade's adopted budget is at 96.0% of maximum for FY 2002, with the five-year average proposal, Belgrade's adopted budget would be103.3% of maximum. The five-year average would require Belgrade to adopt a budget 3.3% lower. See page X Possible Solutions for districts with large changes in enrollment.

Billings High School – The five-year average decreases the maximum budget for Billings by 2.6% in FY 2001 and 2.0% in FY2002. Under current law Billings' adopted budget is at 89.8% of maximum for FY 2002, with the five-year average proposal, the adopted budget would be 91.7% of maximum. The five-year average would not affect the adopted budget.

Outlook Schools – Outlook's budget would not be impacted by the five-year proposal. Its over maximum budget would decline as a percentage of maximum budget.

Applies to all averaging proposals:

Districts at the BASE with declining enrollments (no example given) – Districts at the BASE with declining enrollment will be forced to spend more than current law. Currently 21% of all districts are at the BASE.

How districts would respond

It is unknown how districts would respond within the equalization range to the proposed changes in formula. Districts may choose a higher budget in times of declining enrollment, if they do not prepare for the future reductions, averaging may only delay difficult budget decisions.

Three-year Proposal

The three-year proposal averages the current and previous two years' ANB for each district and then uses this average as the ANB in the funding formula to determine entitlements and maximum budgets. Table 5 uses the same example districts as in Table 3 to depict the resulting effects on districts of the three-year averaging proposal.

Three-year Average Changes from Current Law

Table 5

		2001	2002
Polaris Elementary	Change in ANB	2	2
	% change in Max budget	19.6%	21.8%
	Actual budget	$38,343	$36,033
	Actual % of NEW Max	83.6%	84.1%
Troy Elementary	Change in ANB	14	17
	% change in Max budget	3.4%	4.6%
	Actual budget	$1,560,233	$1,575,898
	Actual % of NEW Max	91.0%	92.9%
Dawson County HS	Change in ANB	16	37
	% change in Max budget	2.6%	6.4%
	Actual budget	$2,924,593	$2,924,593
	Actual % of NEW Max	96.9%	96.8%
Belgrade Elementary	Change in ANB	(17)	(130)
	% change in Max budget	-1.3%	-7.4%
	Actual budget	$5,962,767	$6,652,970
	Actual % of NEW Max	95.2%	103.2%
Billings H S	Change in ANB	(100)	(53)
	% change in Max budget	-1.6%	-1.0%
	Actual budget	$25,862,295	$26,503,152
	Actual % of NEW Max	92.5%	90.7%
Outlook Schools	Change in ANB	7	3
	% change in Max budget	3.1%	3.6%
	Actual budget	$682,096	$679,545
	Actual % of NEW Max	131.8%	131.3%

Polaris Elementary – The three-year average increases the maximum budget at Polaris by 19.6% in FY 2001 and 21.8% in FY2002 over the current law level. Polaris is currently using the "soft cap" provision and has adopted an above maximum budget for FY 2002. Under the three-year average, Polaris's adopted budget for FY2002 would be 84% of maximum instead of 103% of maximum.

Troy Elementary – The three-year average increases the maximum budget at Troy by

3.4% in FY 2001 and 4.6% in FY2002. Under current law Troy is at 97.0% of maximum budget for FY2002, while under the three-year average 92.9% of maximum. Troy's adopted budget would not be affected by this proposal.

Dawson County High School – The three-year average increases the maximum budget at Dawson by 2.6% in FY 2001 and 6.4% in FY2002. Under current law this district is using the "soft cap" provision and has adopted an above maximum budget for the current year. Under the three-year average, Dawson's adopted budget for FY2002 would be 96.8% of maximum instead of 103% of maximum. Dawson could have adopted a higher budget under the three-year average proposal.

Belgrade Elementary – The three-year average decreases the maximum budget for Belgrade by 1.3% in FY 2001 and 7.4% in FY2002. Under current law Belgrade's adopted budget is at 96% of maximum in FY 2002, with the three-year average proposal, Belgrade's adopted budget would be 103.2% of maximum. This above maximum budget would have to be reduced under the three-year average proposal. See page X Possible Solutions for districts with large changes in enrollment.

Billings High School – The three-year average decreases the maximum budget for Billings by 1.6% in FY 2001 and 1.0% in FY2002. Under current law Billings adopted budget is at 89.8% of maximum in FY 2002, with the three-year average proposal, the adopted budget would be 90.7% of maximum. The Billings adopted budget would not be impacted by the three-year average proposal.

Outlook Schools – Outlook's budget would not be impacted by the three-year proposal. Its over maximum budget would decline as a percentage of maximum budget.

Two-year Proposal

The two-year proposal averages the current and previous year's ANB for each district and then uses this average as the ANB in the funding formula to determine entitlements and maximum budgets. Table 6 uses the same example districts as in Table 3 to depict the resulting effects on districts of the Two-year averaging proposal.

Two-year Average Changes from Current Law

Table 6

		2001	2002
Polaris Elementary	Change in ANB	2	1
	% change in Max budget	19.6%	10.9%
	Actual budget	$38,343	$36,033
	Actual % of NEW Max	83.6%	92.4%
Troy Elementary	Change in ANB	7	12
	% change in Max budget	1.6%	3.4%
	Actual budget	$1,560,233	$1,575,898
	Actual % of NEW Max	92.6%	94.0%
Dawson County HS	Change in ANB	3	35
	% change in Max budget	0.5%	6.1%
	Actual budget	$2,924,593	$2,924,593
	Actual % of NEW Max	98.9%	97.1%
Belgrade Elementary	Change in ANB	(17)	(123)
	% change in Max budget	-1.2%	-6.9%
	Actual budget	$5,962,767	$6,652,970
	Actual % of NEW Max	95.1%	102.6%
Billings H S	Change in ANB	(46)	(31)
	% change in Max budget	-0.7%	-0.6%
	Actual budget	$25,862,295	$26,503,152
	Actual % of NEW Max	91.7%	90.4%
Outlook Schools	Change in ANB	4	1
	% change in Max budget	0.7%	3.3%
	Actual budget	$682,096	$679,545
	Actual % of NEW Max	134.9%	131.8%

Polaris Elementary – The two-year average increases the maximum budget of Polaris Elementary by 19.6% in FY 2001 and 10.9% in FY2002 over the current law level. Polaris is currently using the "soft cap" provision and has adopted an above maximum budget for FY 2002. Under the two-year average, Polaris's adopted budget for FY2002 would be 92.4% of maximum instead of 103.0% of maximum, which would allow the district to adopt a higher budget than under current law.

Troy Elementary – The two-year average increases the maximum budget at Troy by 1.6% in FY 2001 and 3.4% in FY2002. Under current law Troy is at 97.0% of maximum budget for FY2002, while under the two-year average 94.0% of maximum. Troy's

adopted budget would not be impacted by the two-year average proposal.

Dawson County High School – The two-year average increases the maximum budget at Dawson by 0.5% in FY 2001 and 6.1% in FY2002. Under current law this district is using the "soft cap" provision and has adopted an above maximum budget for the current year. Under the two-year average, Dawson's adopted budget for FY2002 would be 97.1% of maximum instead of 103.0% of maximum. Dawson could adopt a 3% higher budget under the two-year average proposal.

Belgrade Elementary – The two-year average decreases the maximum budget for Belgrade by 1.2% in FY 2001 and 6.9% in FY2002. Under current law Belgrade's adopted budget is at 96.0% of maximum in FY 2002, with the two-year average proposal, Belgrade's adopted budget would be 102.6% of maximum. See page X Possible Solutions for districts with large changes in enrollment.

Billings High School – The two-year average decreases the maximum budgets by 0.7% in FY 2001 and 0.6% in FY 2002. Under current law Billings' adopted budget is at 89.8% of maximum in FY 2002, with the two-year average proposal, the adopted budget would be 90.4% of maximum. The Billings adopted budget would not be impacted by the two-year average proposal.

Outlook Schools – Outlook's budget would not be impacted by the two-year proposal. Its over maximum budget would decline as a percentage of maximum budget.

Summary of Impacts to Districts

Districts with declining enrollments would see larger increases from current law in budget authority and state aid with the five-year proposal than the two-year or three-year proposals. Table 7 on the following page, summarizes the effects in the formula. If the ANB change is an increase, then the changes in budget authority are negative as lower prior year ANB are averaged with the higher current year ANB. If the ANB change is a decrease then the changes in budget authority are positive. Larger changes in enrollment also lead to larger changes in budget authority over current law.

The increasing and decreasing enrollment do not change by the same percentage, because the measure is from a higher number to a lower number (e.g. 9/10 -1= -10%) in the case of increasing enrollment and lower number to higher number (e.g. 10/9 – 1 = 11%) in decreasing enrollment, while in both cases the absolute dollar amount is the same.

Change in State Aid and Budget Authority over Current Law

(for per ANB entitlements)

Table 7

Annual Enrollment Change	5-year Average	3-year Average	2-year Average
Delcining Enrollment			
2%	4.2%	2.1%	1.0%
5%	11.1%	5.4%	2.6%
10%	24.8%	11.5%	5.6%
Increasing Enrollment			
2%	-3.8%	-1.9%	-1.0%
5%	-9.1%	-4.7%	-2.4%
10%	-16.6%	-8.8%	-4.5%

The current funding of schools is based on ANB, which is based on enrollment from the previous year. In other words, the current funding formula is already lagged one year. Averaging further lags the effects of changing enrollment.

Under the five-year average, a district with five years of ANB declining 10% per year would have lost one third of its enrollment, and about 20% of its budget authority, compared with one third of its budget authority under current law. A district with 5,000 ANB in the first year would have an enrollment of 2,952 in year following the fifth year, and would be funded for ANB of 4,095. Under the two-year average, this district would have enrollment of 2,952 and be funded for ANB of 3,463 (17% more ANB than enrollment). Under current law, this district would receive the prior year's ANB or 3,281 (11% more than enrollment).

The same could be true in reverse for districts with increasing enrollment. Using a five-year average it could take many years for the ANB to catch up with enrollment. With very large changes in enrollments, the averaging does not seem to make much sense. During times of very large enrollment changes, budgeted ANB may need be closer to true enrollment. Averages over fewer years of ANB will keep budgeted ANB closer to real enrollment than will the five-year average, but can still cause extreme circumstances when enrollments change suddenly.

Possible solution for districts with large changes in enrollment
Large changes in enrollment over a short period of time may cause districts to move more quickly to hire new staff or find new space. Students may not fit in the current space and temporary space may be needed. They may also give districts opportunities to close space, and release staff more quickly than they might if the loss was small. Any averaging formula will need to address these cases.

Current law, MCA 20-9-314, allows districts to increase ANB when the increase is above six percent, the state will adjust its payments to the districts by the amount over six percent. The current law is not written in a way that can easily be applied with these averaging proposals. However, it is a concept that may be useful for solving the problems that arise from large changes in enrollments.

Extremely Small school exception
Extremely small schools do not seem to be well suited to averaging since even with averaging, changes can be extreme. The council may wish to consider a different solution for extremely small schools. One option may be a larger basic entitlement for elementary schools with ANB not being applied to the first X number of ANB. There may also need to be minimum school sizes to qualify for state assistance, or other rules to insure that districts that are not necessary get consolidated.

Statewide summary of proposals

The cost of these proposals to the state general fund is substantial. The following Table 9 summarizes the results.

Summary of Increased Cost to the State General Fund from Averaging Enrollments

Table 9

in millions	2001	2002	2003
Two-year average	$3.49	$4.99	$4.97
Three-year average	$5.55	$7.68	$7.94
Five-year average	$9.81	$12.95	$14.05

These increased costs can be compared to an across the board increases in entitlements. A 1% increase in entitlements cost approximately $4.78 million. The Two-year proposal costs about the same as a 1% increase, the three-year is about the same as a 1.6% increase, and the five-year proposal cost about the same as 2.5 to 3% increase in entitlements.

Cost to Local taxpayers

Districts with declining enrollments

The cost to local taxpayers in districts with declining enrollments could be higher or lower than current law. In general budgets will be as high or higher. If budgets do not increase as a result of averaging, the state will be paying a higher amount and local taxpayers will pay less. If school boards choose higher budgets as a result of averaging, then local taxes may be higher.

Districts with increasing enrollments

In districts with increasing enrollments, the state will be paying a less, due to the average ANB being below the current law ANB. Local taxpayers will usually pay more in districts with increasing enrollments.

Conclusion

Averaging ANB may be a good option for easing the reductions from declining enrollment for many districts. Averaging may cause concerns among districts with rapidly increasing enrollments and some method of addressing rapidly changing enrollments needs to be included in an averaging proposal. Extremely small schools will continue to be a problem even with averaging. Some method of leveling out the payments to schools under one class room would be beneficial to those schools.

Questions:

1. Should averaging be used to smooth enrollment patterns for schools?

2. If so, how many years is the right number of years to average over?

3. Should there be adjustments in the ANB if there is a great difference between averaged ANB and actual enrollment?

4. Should there be a different type of calculation for extremely small schools?